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December 28, 2005

BY HAND AND E-FILING
Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: D.T.E. 05-85, NSTAR Electric/NSTAR Gas, Proposed Rate Settlement

Dear Ms. Cottrell:

Enclosed herewith on behalf of ISO-New England Inc. ("ISO") is a courtesy copy of the Comments that ISO will provide at the Public Hearing in Boston tomorrow evening. Due to the compressed timeframe attending the review of the Proposed Rate Settlement, ISO is providing this copy of its Comments now (in advance of tomorrow's hearing) to allow the opportunity for some meaningful consideration of matters that ISO suggests are very important.

If there are any questions about this filing, kindly contact the undersigned.

Very truly yours,

Eric J. Krathwohl

Enclosure

cc: Paul G. Afonso, Chairman
James Connelly, Esq., Commissioner
W. Robert Keating, Commissioner
Judith F. Judson, Commissioner
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COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and NSTAR Gas Company, pursuant to General Laws Chapter 164, § 94, and 220 C.M.R. §§ 5.00 et seq. for approval of a rate settlement effective January 1, 2006.	D.T.E. 05-85

COMMENTS OF ISO NEW ENGLAND INC.

I. INTRODUCTION

ISO-NE Inc. ("ISO")[1] appreciates the opportunity to present its views on portions of the Settlement proposed in this proceeding.

The Department of Telecommunications and Energy ("DTE" or the "Department") opened this docket to review the Petition of Boston Edison Company Cambridge Electric Light Company, Commonwealth Electric Company d/b/a NSTAR Electric ("NSTAR Electric" or the "Company"), and NSTAR Gas Company pursuant to General Laws Chapter 164 section 94 and 220 C.M.R. 5.00, for approval of a rate settlement effective January 1, 2006 (the "Settlement"). The Settlement was signed by several parties, including the Attorney General of the Commonwealth of Massachusetts (the "AG"). The aspects of the Settlement that are pertinent to the ISO's interests and are discussed herein, are:

[1] ISO- is the private, non-profit Independent System Operator for New England, located at One Sullivan Road, Holyoke, Massachusetts, that is responsible for the day-to-day operation of New England's bulk electric generation and transmission system (the "System"). More specifically, ISO is the independent entity that, pursuant to agreements and tariffs filed with and authorized, from time to time, by the Federal Energy Regulatory Commission ("FERC"): (i) operates the New England Control Area; (ii) administers the Open Access Transmission Tariff ("OATT"); and (iii) administers a power exchange consisting of several Markets and provides administrative support for bilateral and self-scheduled transactions. ISO has the responsibility to protect the short-term reliability of the control area, to administer competitive and efficient wholesale markets, and to plan for and ensure a reliable bulk power system for New England.

- Section 2.32. This Section provides that: "NSTAR Electric shall continue to pursue through litigation at the FERC, and otherwise, to advocate on behalf of its customers in order to mitigate electricity market inefficiency costs. The Settling Parties agree that, if such initiatives are successful, it is appropriate that NSTAR Electric share with customers in the benefits that result from reductions in the costs of energy, capacity reserves and operating reserves that result from reducing transmission constraints and market inefficiencies...".

- Section 2.33. This Section provides: "that NSTAR Electric and the Attorney General shall work together to develop a program to identify the causes for the difference between the actual electric market dispatch in New England and the unconstrained marginal cost dispatch..."

- Section 2.34 This section provides that: "NSTAR Electric and the Attorney General shall work together to minimize unnecessary Reliability Must Run ("RMR") costs and will develop an incentive mechanism to limit the impact of RMR costs on NSTAR Electric customers."

- Section 2.35. This section provides that "...any customer benefits, as shall be mutually agreed upon and quantified by the Attorney General and NSTAR Electric or as determined by the Department, accruing to the customers of NSTAR Electric and resulting from actions taken by NSTAR Electric pursuant to paragraphs 2.32 through 2.34 shall be shared on the basis of 75 percent for customers and 25 percent for NSTAR Electric..."

While the goals underlying the Settlement provisions noted in the preceding paragraph (market efficiency etc.) are laudable, they are no different from the goals of any other market participant or of ISO itself. Therein lies a crucial problem with the portions of the Settlement that ISO objects to: because many interested parties and ISO are all working to achieve such cost savings, admittedly with different views as to the best means of achieving such goals or even, perhaps, how to measure such cost savings, it will be most difficult to determine whether cost savings result from the efforts (referred to as "initiatives" in the Settlement) of NSTAR or some other party. Even if an NSTAR position nominally identifies savings in the short term, in the long run it may be more costly. The bottom line is that despite the ambiguity in the "metric" by which NSTAR's actions are to be judged (ambiguity which is problematic in and of itself),

NSTAR is incentivized to pursue its positions only through litigation, because any NSTAR claim that "its initiatives" resulted in any later-identified benefits is more easily supported by NSTAR if it can point to a position it has taken in an adversarial proceeding.

In addition, the Settlement provides an incentive that could be far out of proportion relative to any efforts by NSTAR. As described in Section II.A. below, ISO fears that approval of the Settlement (specifically those provisions concerning litigation on wholesale market matters) could lead to litigation positions and tactics by NSTAR that will disrupt productive and efficient processes already established to resolve wholesale market issues and that will actually redound to end-use customers' detriment. This latter issue should be of particular concern to the Department where NSTAR takes positions that result in cost-savings to NSTAR's customers only at the expense of other Massachusetts customers outside of NSTAR's service territory. The Settlement lacks any justification for offering NSTAR benefits for shifting costs to other customers in Massachusetts.

II. PORTIONS OF THE SETTLEMENT ARE CONTRARY TO THE PUBLIC INTEREST AND SHOULD NOT BE APPROVED

The Department should limit any approval of the Settlement to exclude approval of sections 2.32, 2.33, 2.34, 2.35 and 2.36 (sometimes herein referred to as the "Litigation Incentive Provisions").[2] Approval of such provisions would be inconsistent with the public interest, bad public policy, inconsistent with precedent, would be an improper delegation of Department authority for retail rate-setting and would involve the

[2] Arguments by Settlement proponents that the Settlement is not separable are not dispositive, as discussed in Section III. below.

Department in matters beyond its lawful jurisdiction. More specifically, the Settlement establishes:

> (a) incentives for NSTAR to litigate, rather than to participate in the NEPOOL process[3] and settlement efforts at the Federal Energy Regulatory Commission ("FERC"), forums which tend to be more efficient and less costly for resolving disputes among regional stakeholders than litigation;
>
> (b) Litigation Incentive Provisions that are simply too vague to approve and whose implementation would be very problematic;
>
> (c) that the Attorney General and NSTAR have control over the Department's central function of retail rate-setting by allowing the Attorney General and NSTAR to determine what amounts of wholesale market costs putatively "saved" by NSTAR Electric's litigation "at FERC and otherwise" (presumably including appeals) should be recovered by retail ratepayers;
>
> (d) Litigation Incentive Provisions that are inconsistent with Department precedent; and
>
> (e) Litigation Incentive Provisions that result in jurisdictionally improper determinations by the AG and the Department about wholesale electric market design and what efforts yield benefits in that regard.

A. The Settlement Improperly and Inefficiently Encourages Litigation.

The Litigation Incentive Provisions strongly encourage NSTAR Electric to abjure from the well-established and often productive settlement processes through the existing efforts of the NEPOOL stakeholder group[3] and then attack any resulting consensus positions through "litigation at FERC, or otherwise" (*i.e.* appeals) in order to preserve NSTAR's ability to argue later that "its initiatives" resulted in cost savings. It is ironic that NSTAR Electric touts the benefits of the Settlement in avoiding litigation at the retail

[3] The NEPOOL Process is established by Section 11 of the Participants Agreement which is part of a package of operative documents creating ISO-NE as an RTO. These provisions require that all changes to the ISO Tariff (including market rules) must be taken through the appropriate NEPOOL committee[s] (which have certain procedural rights regarding how many meetings, delays, etc.) and then each change must be taken to the Participants Committee for its vote. Different types of changes require different percentages for approval and if the ISO and NEPOOL disagree there is a "jump ball" provision for alternative filings.

level, but simultaneously urges approval of an incentive mechanism designed to bypass stakeholder consensus building or more formal settlement efforts in favor of litigation at the wholesale level. The Litigation Incentive Provisions would allow NSTAR Electric to keep for its shareholders 25% of "reductions in the costs of energy, capacity reserves and operating reserves that result from reducing transmission constraints and market inefficiencies" resulting from its initiatives. *See* Settlement Sections 2.32 and 2.35. The same incentives would be available for the cost difference between "actual electric market dispatch in New England and the unconstrained marginal cost dispatch" (sections 2.33 and 2.35). As discussed further below, without an *a priori* definition of how to measure market inefficiencies and other costs, the Settlement could very well send an incentive to NSTAR simply to seek to shift costs (such as, for example, RMR-related costs) to other customers in Massachusetts that are outside its service territory (Sections 2.34 and 2.35). Additionally, the Litigation Incentive Provisions would allow NSTAR Electric to recover 75% of its FERC Litigation costs, apparently as an "add-on" to whatever rates are otherwise set.[4]

By contrast, the Settlement provides no incentive for NSTAR Electric to continue to seek solutions through the existing NEPOOL process. Thus, the Litigation Incentive Provisions establish a clear and compelling economic incentive for NSTAR Electric to litigate rather than to work through the NEPOOL process. The Litigation Incentive Provisions also could generate a significant volume of new complaints by NSTAR Electric that might only lead to higher wholesale costs – at least in terms of increasing ISO's own litigation costs, which are recoverable under its FERC-approved self-funding

[4] Although NSTAR portrays this as a concession on their part to purportedly give up 25% of litigation costs they could otherwise recover, such costs would be so far exceeded by the 25% of potential wholesale market savings as to be improper *per se*.

tariff. NSTAR Electric would be risking only a relatively small portion of its litigation expense, while potentially receiving a significant windfall - - at the end-use customers' expense - - that might have no logical correlation to its efforts. That result, in itself, is bad policy and contrary to the public interest.

B. The Settlement's Litigation Incentive Provisions Are Simply Too Vague to Approve and Implementation Would Be Very Problematic.

The Settlement's Litigation Incentive Provisions would allow significant reallocation of wholesale power (and transmission) cost benefits from NSTAR Electric's customers to NSTAR Electric's shareholders. Yet the Settlement only identifies the "benefits" in the most general of terms. What those benefits are would be subject to the later determination by the AG and NSTAR Electric. The Settlement provides no guidance as to how such a determination would be made and there is no basis in the Settlement for the Department or any party to review the reasonableness of such determination. In fact, such determination would be extremely subjective and potentially arbitrary. In addition, NSTAR may argue that the appropriate metric for reviewing NSTAR's "initiatives" is cost savings (*e.g.* RMR-related costs) only to *their own customers* – initiatives which may, however, result in *cost increases* to other customers in Massachusetts.

While it may be possible for one to determine the difference in various wholesale power and transmission costs at point A and at point B, it is likely most difficult to assign causation for the difference. Various market events or economics may drive the difference. Even to the extent that market structuring efforts at FERC may be the cause, it will be most difficult to determine that cost reductions resulted from litigation efforts by NSTAR Electric or proposals by other parties to the FERC litigation, such as ISO-NE.

Certainly, the goal of ISO-NE is to achieve efficient wholesale markets – a result which benefits *the region at large* – which in turn should yield cost reductions for end-use customers, subject to costs necessary to ensure reliability. Additionally, the Settlement appropriately notes the importance of reliability (section 2.33), but provides no discussion of how the balance of cost reductions and reliability is to be achieved and if cost reductions are achieved, whether there was a concomitant increase in end-use customers' total incurred costs due to a reduced level of reliability.

C. Approval of the Settlement's Litigation Incentive Provisions Would Improperly Cede Retail Ratemaking Authority to the AG and NSTAR Electric.

Under the Settlement, NSTAR Electric and the Attorney General not only will "identify and [ ] agree on incentive mechanisms" (section 2.33) and will "develop an incentive mechanism" (section 2.34) but also will agree on and quantify any customer benefits accruing to NSTAR Electric customers (section 2.35). While the Settlement gives a cursory nod to the Department's ultimate authority over retail rates, the Settlement does not contemplate or describe an open and measured investigation by the Department into the actions described above that might more normally be the province of the Department itself. Unless there were to be a truly open proceeding with the full process (notice, intervention, participation by interested parties, discovery, hearings, briefing and reasonable time for Department deliberations), as opposed to the Settlement's contemplation of only a cursory or abbreviated review and approval of incentive payments to NSTAR Electric, the traditional role of the Department in approving retail rates with respect to the costs subject to the Litigation Incentive

Provisions will have been improperly shifted to the Attorney General and NSTAR Electric.

D. The Settlement's Litigation Incentive Provisions Are Inconsistent with Department Precedent.

Section 2.32 provides an extraordinary incentive to NSTAR Electric that, to this commenter's knowledge, is both unprecedented and likely contrary to Department precedent. To the extent that NSTAR Electric and the AG agree that some of NSTAR Electric's efforts led to reductions in costs of energy, transmission, or other wholesale market charges, NSTAR Electric would be entitled to keep for its shareholders 25% of such savings. The Settlement proponents make no offering of supportive precedent and, indeed, ISO is not aware of any on point. Rather, incentives for distribution companies' cost reductions or recoveries have been allowed normally when those amounts are fairly easily and *objectively* quantifiable. For example, incentives have included a percentage of cost savings derived from accepted calculation methodologies (*e.g.* DSM program benefits, *Boston Edison Company*, D.P.U. 90-335 (1992)), amounts derived from a set formula for achievement of specific performance targets (*Energy Efficiency Program Evaluation and Approval*, D.P.U. 89-100, Section II.F.(2000)), or insurance recoveries, (*Manufactured Gas Plant Cost Recovery*, D.P.U. 89-161 (1989). In those cases, there is an accepted calculation to determine DSM program benefits and the MGP remediation insurance cost recoveries would simply be the dollar amount tendered by an insurance provider. Further, in such cases it is clear that the savings result from the distribution company's efforts. In contrast, here even the existence of the savings may be subject to considerable debate (even if the AG and NSTAR Electric agree among themselves), much less the extent of savings that are attributable to the litigation efforts of NSTAR

Electric at FERC or otherwise. Further, what are savings for NSTAR customers may be additional costs for customers in other parts of the Commonwealth. Thus, the Settlement stretches precedent for litigation incentives well beyond its breaking point.

Similarly, as to the litigation costs sharing, the Settlement is not consistent with applicable precedent. The Department's precedent would allow a distribution company's recovery of litigation costs where the utility shows that the costs in question are reasonable and where the company demonstrates that it has a reasonable process for evaluating the cost effectiveness of its litigation efforts (including a monitoring and review of the litigation costs). *Commonwealth Electric Company*, D.P.U. 89-114/90-331/91-80 Phase I (1990). In contrast, the Settlement makes no offering that only costs meeting such standard would be collected and it is not clear that any process for determining the reasonableness of the costs would be employed. Any such process would of course entail notice and opportunity to comment by interested parties.

E. The Settlement Would Involve the Department in Matters Beyond Its Lawful Jurisdiction

The Litigation Incentive Provisions establish that NSTAR is entitled to 25% of the benefits that result from NSTAR's "litigation at FERC and otherwise". Whether it is NSTAR and the AG that initially determine the existence or level of such benefits and the DTE reviews that determination, or if the DTE makes the initial determination, the DTE will be thrown into a determination of wholesale rate matters. Such matters are, of course, beyond the jurisdiction of the Department. NSTAR's summary denial of any improper invasion of FERC's jurisdiction in its response to Constellation Energy's December 20, 2005 Comments, is simply inadequate.

Even if the Settlement does not specifically address the substance of positions to be taken in FERC proceedings (or appeals thereof), and even if the Settlement nominally just addresses retail rates, any effort to determine the level of the retail incentive necessarily and improperly implicates FERC jurisdictional matters. The level of the incentive depends on the "benefits" resulting from NSTAR's efforts litigating at FERC or otherwise. However, determination of the benefits requires a broad perspective about what the wholesale electric market ought to be and what costs were eliminated by a particular position advocated by NSTAR. Unfortunately, that is a determination that can only be made by FERC. Consequently, where a determination of the existence and level of wholesale market cost savings for which an incentive applies requires a full consideration of wholesale electric market issues, such a determination goes well beyond state-level retail jurisdiction. This jurisdictional infirmity exists even if the implementation of the incentive is through the retail rates of NSTAR (the setting of which is up to the Department).

III. PROCEDURAL ISSUES

As the Department is well aware and as several parties have commented, the context of reviewing the Settlement in an extraordinarily compressed timeframe likely compromises the ability of parties to review the Settlement and to provide input on issues that are worthy of more measured consideration. While a more extended proceeding would allow the Department and parties to more fully explore the merits and disadvantages of the Settlement, nonetheless, ISO appreciates the opportunity to be heard.

The Department should not accept improper settlement provisions (as discussed herein) simply because that NSTAR and perhaps other Settlement proponents would urge that the Settlement is an integrated whole that only stands if every piece of it is approved as proposed. Indeed, the Department could simply note its disapproval of the Litigation Incentive Provisions and at the worst, the settling parties could determine whether to proceed with the remainder of the Settlement, as approved. Although the Litigation Incentive Provisions are sufficiently concrete to be improper and objectionable for the reasons stated in these Comments, ISO surmises that the uncertainties that remain for NSTAR Electric's recovery of costs under such provisions is such that no settling party has placed a tremendous value on those provisions. Therefore, disapproval of such provisions will likely not affect the implementation of the remainder of the Settlement if the Department deems that appropriate.

IV. CONCLUSION

For the reasons set forth above, ISO respectfully urges the Department to reject and disapprove Sections 2.32 through 2.36 of the Settlement.

Respectfully submitted,

ISO NEW ENGLAND INC.

By Its Counsel

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Dated: December 28, 2005

SERVICE LIST – D.T.E. 05-85

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COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS

AND ENERGY

D.T.E. 05-85

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all parties of record in this proceeding in accordance with the requirements of 220 CMR 1.05(1) (Department's Rules of Practice and Procedure).

Dated at Boston, Massachusetts this 28th day of December, 2005.

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